

Revised Initial Statement of Reasons

Proposition Player Registration and Licensing; Gambling Businesses

PART ONE: Proposition Player Registration and Licensing

The California Gambling Control Commission (“Commission”) is mandated by statute to adopt regulations governing the operation of third-party proposition player services.¹ Also, the Division of Gambling Control in the California Department of Justice (“Division”) is authorized by statute “pursuant to regulations of the Commission” to perform background checks, financial audits and other investigatory services as needed to assist the Commission in the regulation of third party proposition player services,² and to adopt emergency regulations establishing reasonable fees and deposits to fund these activities. The Division plans to adopt regulations setting fees and deposits.

In order to more promptly address reported criminal activities and ensure that felons were not working in the industry, the Commission adopted regulations on an emergency basis in October 2003. This Initial Statement of Reasons has been prepared in support of the rulemaking action that will make these emergency regulations permanent.

The key statutory authority for these regulations is found in the Gambling Control Act, specifically in Business and Professions Code section 19984. Section 19984 (“Contracts for Providing Proposition Player Services”), quoted in full in the footnote.³

¹ Gambling business regulations will be discussed in Part Two of this document.

² The term “proposition player” or “proposition play” is sometimes abbreviated as “PP.”

³ “Notwithstanding any other provision of law, a licensed gambling establishment may contract with a third party for the purpose of providing proposition player services, subject to the following conditions:

- (a) Any agreement, contract, or arrangement between a gambling establishment and a third-party provider of proposition player services shall be approved in advance by the division, and in no

The proposition player regulations are grounded on the public policy concerns articulated by the Legislature in enacting the Gambling Control Act. The basic purpose of the regulatory scheme is to protect the public by ensuring that permissible gambling is free from criminal and corruptive elements and that it is conducted honestly and competitively (see Business and Professions Code section 19801, subdivision (f)). “Public trust and confidence can only be maintained by strict and comprehensive regulation of all persons, locations, practices, associations, and activities related to the

event shall a gambling establishment or the house have any interest, whether direct or indirect, in funds wagered, lost, or won.

- (b) The commission shall establish reasonable criteria for, and require the licensure and registration of, any person or entity that provides proposition player services to gambling establishments pursuant to this section, including owners, supervisors, and players. Those employed by a third-party provider of proposition player services, including owners, supervisors, observers, and players, shall wear a badge which clearly identifies them as proposition players whenever they are present within a gambling establishment. The commission may impose licensing requirements, disclosures, approvals, conditions, or limitations as it deems necessary to protect the integrity of controlled gambling in this state, and may assess and collect reasonable fees and deposits as necessary to defray the costs of providing this regulation and oversight.
- (c) The division, pursuant to regulations of the commission, is empowered to perform background checks, financial audits, and other investigatory services as needed to assist the commission in regulating third party providers of proposition player services, and may assess and collect reasonable fees and deposits as necessary to defray the costs of providing this regulation and oversight. The division may adopt emergency regulations in order to implement this subdivision.
- (d) No agreement or contract between a licensed gambling establishment and a third party concerning the provision of proposition player services shall be invalidated or prohibited by the division pursuant to this section until the commission establishes criteria for, and makes determinations regarding the licensure or registration of, the provision of these services pursuant to subdivision (b).” (Business and Professions Code section 19984; emphasis added.)

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operation of lawful gambling establishments (Business and Professions Code section 19801.) Proposition player services are required to maintain records in order to provide an audit trail which will facilitate detection of money laundering and other illegal activities. See Business and Professions Code section 19801(m) (records may have a high degree of usefulness in criminal and regulatory investigations). Costs of providing this strict and comprehensive regulation and oversight are to be defrayed by fees collected from registrants and licensees. See Business and Professions Code section 19984, subdivision (b).

The statutes and regulations governing the licensing of cardrooms and cardroom employees provide the model for many of the proposition player regulations. The basic licensing categories applying to cardrooms are (1) gambling license, (2) key employee license, and (3) work permit. See definitions in Business and Professions Code section 19805, subdivisions (n), (t), (u), and (ee), as well as sections 19850-19990 (licenses) and 19910-19915 (work permits). The proposition player regulations include the categories of primary owner, owner, supervisor, player and “other employee.” The primary owner and owner are comparable to the holder of a gambling license; the supervisor to the key employee; and the player and “other employee” to the holder of a work permit. Commission regulations concerning applications for gambling licenses and key employee licenses are found in Title 4 California Code of Regulations (“CCR”) sections 12250-12271. Commission regulations concerning applications for work permits are found in Title 4 CCR sections 12100-12142.

Section 12200. Definitions

Definitions for key regulation terms are needed in order to make clear what the terms are intended to mean.

Section 12200.1 Certificate

It is important to articulate the content and name of the document obtained in response to an application.

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Section 12200.3 Badge

For purposes of enforcement and compliance, each registrant or licensee is issued and required to wear a badge when on duty. Badges of one color are issued to players; badges of another color are issued to non-playing persons.

Section 12200.5 Replacement or Transfer of Badge; Additional Badges

Procedures are needed when a badge is lost or misplaced, when a registrant desires to transfer from one primary owner to another, and when a registrant desires to work for an additional primary owner (for instance, when the first position is not fulltime).

Section 12200.7. Proposition Player Contract Criteria

Specific information is needed concerning, for instance, the parties to the contract. Provisions are included to ensure that proposition players employees are assessed the same playing charges as are assessed against all patrons. Other provisions are intended to ensure that PP providers are not in effect paying a percentage of their winning to the house, in violation of law.

Section 12200.9 Review and Approval of Proposition Player Contracts.

Procedures are needed concerning the routine and expedited review of proposed contracts by the Division, including forms, fees, deposits, and review by the Commission.

Section 12200.11 Proposition Player Contract Extensions

Contracts approved since October 2003 are limited to one year and will be expiring as time passes. Procedures are needed to deal with contracts proposed for extension or renewal.

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Section 12200.13 Playing Books

To prevent money laundering, loan sharking, theft, etc., complete records of money and chips received at the start of a shift and money and chips returned at the end of a shift.

Section 12200.15 Transfers and Sales

To prevent criminal or corruptive elements from penetrating the industry, all proposed buyers apply for registration or licensing and be approved prior to taking over a PP business.

Section 12200.16 Inspections

State representatives must have quick access to records to ensure that required procedures are being followed

Section 12200.17 Emergency Orders

On occasion, it will be necessary to act quickly to shut down registrants or licensees.

Section 12200.18 Revocation

This section lists grounds of revocation. The grounds include matters which are incompatible with functioning as a proposition player and handling large amounts of money, including violation of the Gambling Control Act, embezzlement, and engaging in activities that facilitate money-laundering or loan sharking.

Section 12200.19 Special Authorizations and Limitations

Specifying that a supervisor can function as a player eliminates the need to obtain multiple registrations.

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Limiting those who control currency and chips to authorized players is necessary corollary to the provisions creating two badge categories—playing and nonplaying.

Section 12200.20. Non-refundable Annual Fee

Business and Professions Code section 19984(b) authorizes the Commission to “assess and collect reasonable fees and deposits as necessary to defray the costs of providing this regulation and oversight.” Section 12200.20 is intended to obtain sufficient annual fees to defray these costs. Cost data supporting the proposed fee is attached as Appendix “A.”

Section 12200.25 Transition to Licensing

Subsection (a) prohibits persons from working as proposition players unless they have first been licensed. Recognizing that licensing will in fact take time to implement, the subsection permits registrants to continue to provide services until the Commission grants or denies a license.

Because staffing at the Division does not permit all needed background investigations to be conducted at the same time, this section outlines a system under which the Division will call forward registrants over a period of time, directing them to file a license application within 30 days. The registrations of any who fail to file within 30 days will expire by operation of law. This provision is needed to ensure that applications for licensing are submitted in a predictable and orderly fashion. To ensure that the transition to licensing is completed within a reasonable period of time, this section specifies that the transition is to be completed no later than January 30, 2007, approximately two and one-half years from the date that this Initial Statement of Reasons was prepared.

Section 12201. Registration

This section outlines some of the basic features of the registration system. Originally effective on an emergency basis, this regulation provided in subsection (a) that no person currently providing PP services could continue providing such services—unless registered—beginning 120 days after the emergency regulation took effect. In a subsequent emergency readoption,

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the original 120-day deadline was extended to March 31, 2004. Subsection (a) is still needed in order to ensure that no person can provide PP services without first being registered with the Commission.

Subsection (b) is needed in order to provide the term during which a registration is valid.

Subsection (c) provides that the registration program will eventually be superseded by a licensing program, and that obtaining registration does not create any vested right to licensing. Requirements applying to licensing applications may differ from those that currently apply to registration applications: for example, there may be additional or more demanding requirements applying to licensing. This subsection explains the planned transition from registration to licensing, and makes clear that the Commission retains the authority to deny a licensing application despite the fact that the applicant may have previously been granted a registration. In contrast to registration, the licensing phase will entail a full background investigation, which may result in some denials.

Subsection (d) is needed in part to specify which persons related to a primary owner that is a business entity must individually apply for registration. Business and Professions Code section 19852, which by its terms applies solely to cardrooms, requires related persons such as corporate officers to apply for cardroom licenses. The related persons sometimes have past associations or criminal background that render them unsuitable for licensing as cardroom owners. The same policy considerations apply to owners of PP services.

In addition, Subsection (d) is needed to identify persons who are not eligible to obtain a PP registration. Subsection (d) prohibits any business entity or sole proprietor licensed under the Gambling Control Act to operate a cardroom from also becoming registered as a proposition player. This provision is needed in order to comply with the prohibition against house banking (see, e.g., Business and Professions Code section 19984(a)). During the public input process leading up to adoption of the emergency regulation that is currently in effect, consideration was given to additionally banning (for example) not just corporations that were licensed to operate cardrooms from PP registration, but also investors in these licensed corporations. Persons owning interests in cardrooms objected to this additional limitation

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as unnecessary, as infringing upon their constitutional rights; lawsuits were threatened.

The Commission selected the policy alternative reflected in the current Section 12201(d) (the emergency regulation). In compliance with the APA, this Initial Statement of Reasons includes (Below) a showing of necessity for this adopted provision. However, because of the public interest in this issue, the Commission has included in the text of the proposed permanent regulation two additional alternative approaches to this issue. After considering public input concerning the three alternatives, the Commission will make a final decision later this year and submit the final text of the regulation to the Office of Administrative Law.⁴

The policy alternative reflected in the current Section 12201(d) (the emergency regulation) was selected for the following reasons:

- (1) The issue of collusion has been dealt with by including contract review provisions designed to prevent the possibility of collusion between cardroom owners and PP providers. A provision was drafted ensuring that the Division would review all proposed contracts with an eye toward existence of any real or perceived collusive arrangement. Section 12200.9(a)(1)(d) of the proposed permanent regulation (Section 12208(a)(1) of the emergency regulation) provides in part:

“The Division shall approve a proposition player contract only if all the following requirements have been satisfied:

. . . .

“(D) The contract will not undermine public trust that the controlled gambling operations covered by the contract will be conducted honestly, by reason of the existence or perception of any collusive arrangement between any party to the contract

⁴ During the October 22, 2003 meeting at which the emergency proposition player regulations were adopted, Commission staff advised the gathering that the permanent regulation might well contain more stringent limitations on involvement in proposition play services by cardroom investors. More stringent limitations were contained in alternative “(g)” — a policy option rejected by the Commission. The substance of this rejected proposal is contained in the proposed text of the permanent regulation as alternative three.

and the holder of a state gambling license, or otherwise.”
(Emphasis added.)

The Division will also maintain a field presence in cardrooms, and will be in a good position to detect any collusive arrangements that might otherwise emerge. Finally, if reports from the Division, local law enforcement, or other sources suggest that there is a problem in this area, the Commission is prepared to take whatever action is necessary to address it, including amending the PP regulation.

- (2) Needless restrictions on private investment or economic activities are hard to reconcile with various Administrative Procedure Act provisions. One suggested alternative would flatly forbid a private individual who invests in a cardroom business entity from also investing in a PP provider that serves a different cardroom. Such a provision would not only prohibit private individuals from investing their money,⁵ but would also in effect ban the PP companies from receiving the money.

Government Code section 11346.5(a)(12) (part of the Administrative Procedure Act) requires any state agency proposing to adopt a regulation to include in the notice of proposed action:

“A statement that the adopting agency must determine that no reasonable alternative considered by the agency or that has been brought to the attention of the agency would be more effective in carrying out the purpose for which the action has been proposed or would be as effective and less burdensome to affected private persons than the proposed action.” (Emphasis added.)

The first draft of the proposition player regulation banned cross-investment of the kind outlined above. Affected private persons then protested this tentative policy choice to the Commission, arguing that a narrower prohibition would be equally effective in furthering the

⁵ Investors frequently make the wisest decisions when they elect to invest in businesses with which they are familiar. Individuals associated with the cardroom industry are of necessity familiar with the workings of the proposition player industry.

purposes of applicable law, including Business and Professions Code section 19984, and would be less burdensome to them. Responding to these protests, the Commission determined that there was indeed a reasonable, legal alternative to the initial proposal. That two-part alternative is found both in the current emergency regulation and in the proposed permanent regulation. Part one of this alternative is Subsection (d), which prohibits any business entity or sole proprietor licensed under the Gambling Control Act to operate a cardroom from also becoming registered as a proposition player. Part two of this alternative is Section 12200.7(b)(11) of the proposed permanent regulation (Section 12207(b)(10) of the current emergency regulation), which states that:

“A registrant or licensee may not provide proposition player services in a gambling establishment for which the registrant holds a state gambling license, key employee license, or work permit.”

Taken together, these two provisions (both of which are parts of the current emergency regulation) effectively protect the public interest, while at the same time lessening the burden on affected private persons.

- (3) Individuals who have previously obtained licenses as investors in business entities owning cardrooms would in one sense be desirable proposition player investors. These individuals would have already succeeded in passing an intensive background investigation conducted by the Division, which was then reviewed by the Commission. One of the objectives of the PP registration/licensing program is to screen out individuals who are convicted felons, linked to organized crime, etc. Reviewing individuals who have already been licensed by the State in one capacity might well be less time-consuming than might otherwise be the case.

In order to obtain the fullest possible public input, the text of the proposed regulation (section 12201) includes three alternative versions of subsection (d):

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- (1) The language of the current emergency regulation,
- (2) A variation requested at the May 12 rulemaking workshop which makes clear that individual investors in cardrooms may invest in PP providers which serve other cardrooms, and
- (3) A variation that returns to the flat prohibition language originally circulated in January 2002 that was later effectively rejected by the Commission in October 2003.

The Commission will review these three alternatives in light of comments received from the public and will make a final decision later this year.

Section 12202. Application for Registration

It is necessary specify in the application the category of registration sought, who must sign the application, which form must be used, etc. Live Scan Service fingerprinting is required to initiate the background check process. The statutory \$500 application is required, plus photos, one for the badge, one for state records.

Section 12203. Processing of Applications for Initial and Renewal Registration

It is helpful for both applicants and Commission staff to understand the timeframes within which applications must be processed. This regulation provides these timeframes, and also outlines how an application may be withdrawn and when it will be deemed abandoned (in situations in which the applicant fails to responds to written requests for information).

Paralleling cardroom application procedures, subsection (f) requires applications for registration renewal to be received 120 days prior to expiration of the current registration. This lead-time is needed to permit orderly processing of the application, including time to obtain missing information. An expedited processing fee is needed in order to fund overtime work that is typically needed to deal with late filings. The \$60

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figure is derived as follows: one hour of Associate Governmental Program Analyst time costs \$40.70, the overtime work is estimated to take one and one-quarter hours for a subtotal of \$50.88; adding in overhead costs for one and one-quarter hours comes to a grand total of \$63.60.

Section 12203.1 Application for Temporary Player Registration

Cardrooms and proposition player providers have both requested creation of a process in which players can receive temporary registration, pending processing of their regular registration applications. This would permit prospective employees to go to work sooner. This section outlines a process for reviewing such temporary player registration applications that is modeled on the regulation authorizing temporary work permits for cardroom employees.

Section 12204. Ineligibility for Registration

This section lists grounds for denying registration, focusing on criminal convictions and violations of gambling-related statutes and regulations. This is intended to prevent criminal or corruptive elements from entering the industry.

Section 12205. Cancellation of Registration

Registrations are issued based upon an abbreviated background check. This section permits the Commission to cancel a registration if disqualifying information subsequently emerges.

Section 12212. Compliance

This section is designed to ensure that proposition players (1) are not given an unfair advantage over other players and (2) comply with legal requirements concerning rotation of the player-dealer position, see, for instance, Business and Professions Code section 19805(bb).

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Section 12218. Application for Initial Licensing

Due to staffing limitations, registrants will be called forward by the Division over a period of time. Thus, registrants and other persons may not submit license applications without first having been called forward or “summoned” by the Division. In order to ensure that the initial group of registrants is processed first, this section states that subsequent registrants will be called forward after the first group.

This section also prescribes standard application procedures: who signs the application, category of licensing sought, and identification of a standard form.

Section 12218.5 Compliance—Licensing

See section 12212.

Section 12218.7 Background Investigation Deposit

Pursuant to Business and Professions Code section 19984(c), the Division will assess and collect deposits to cover background investigation costs.

Section 12218.9 Term of License

Following the model set in the Gambling Control Act for cardroom licenses and work permits, owner and supervisor licensees will have a one-year term and player and other employee licenses will have a two-year term. However, due to nonrecurring workload problems at the Division, all initial licenses will be for two years. After the initial licenses have been processed, player and other employee licenses will continue to be for two years, while owner and supervisor licenses will be for one year.

PART TWO: Gambling Business Registration Regulations,
Sections 12220—12232

These regulations were adopted at the request of the Division, which was concerned that, absent these regulations, some persons currently engaged in proposition play activities would continue to operate without a contract and thus defeat the purpose of the proposition player regulations adopted in compliance with Business and Professions Code section 19984. These gambling business regulations are authorized by Business and Professions Code section 19853(a)(3), which empowers the Commission to adopt regulations requiring “any person who does business on the premises of a licensed gambling establishment” to register with the Commission.

The specific provisions of these regulations were adopted for the same reasons as their parallel provisions in the proposition player chapter. Section 12232, which is not paralleled in the proposition player chapter, is adopted in order to (1) provide the Commission with the names of persons who should have registered but have not and (2) permit the Commission to advise the unregistered person of the violation.